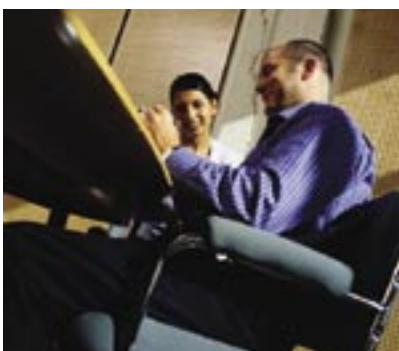
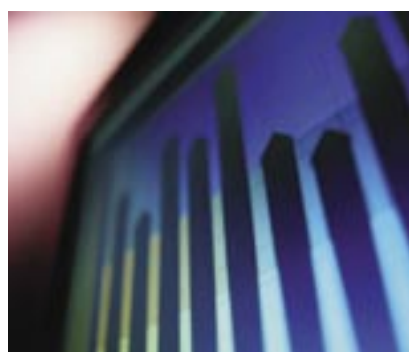




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# FREQUENTLY ASKED QUESTIONS ABOUT FEDERAL OUTSOURCING, COMPETITIVE SOURCING, AND COMPETITION

by Geoffrey F. Segal and Adrian T. Moore



POLICY  
BRIEF

23

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## Policy Brief 23

# Frequently Asked Questions about Federal Outsourcing, Competitive Sourcing, and Competition

By Geoffrey F. Segal and Adrian T. Moore

## 1. What is the Administration's competition program?

Competition is a major component of President Bush's Management Agenda. The concept is called "Competitive Sourcing," which simply means a systematic effort to have all commercial activities in the federal government periodically go through a process of competition. Commercial activities have been identified for several years in the FAIR Act inventories.

President Bush and the Office of Management and Budget have issued requirements that agencies conduct public-private competitions for at least 5 percent of full-time positions in commercial activities by 2002, and be up to 10 percent by the end of 2003.

This competition program is not an outsourcing effort. Competitive sourcing is a process of competition where the group providing the best value to the taxpayers earns the right to perform the function. Historically the in-house federal government team has won more than 51 percent of competitions against private companies.<sup>1</sup>

## 2. What is the President's Management Agenda?

The PMA is a set of initiatives designed to improve the management of federal agencies by adopting performance-based criteria for decision-making and action, and ultimately tying performance to budget appropriations.<sup>2</sup>

The five pillars of the PMA are:



- *Strategic Management of Human Capital;*
- *Competitive Sourcing;*
- *Budget and Performance Integration;*
- *Improved Financial Performance; and,*
- *Expanded Electronic Government.*

### 3. Why is competitive sourcing important?



At its root “competition promotes innovation, efficiency, and greater effectiveness.”<sup>3</sup> Competitive sourcing is part of a performance-based management initiative designed to improve performance and efficiency. Competition done right drives down costs and ratchets up performance, often dramatically. The only long-term study of federal public-private competitions found that competition drove costs down over 30 percent while improving performance.

Without a bottom line and without competitive forces, program structures and approaches often stagnate, and success is not always visible, and is hard to replicate. Worse, since budgets are not linked to performance in a positive way, too often poor performers get rewarded as budget increases follow failure. Applying competition forces management to identify the true cost of doing business, and, with efficiency as a goal, compels an agency to use performance measurement to track and compare quality and value.

### 4. How does competitive sourcing work?

Under the Federal Activities Inventory Reform (FAIR) Act, each agency is required to submit a list of activities to the Office of Management and Budget (OMB). Those lists break down the federal workforce into two broad job classifications: inherently governmental (jobs that only government does or should do) or commercial (jobs that could be provided by the private sector).

From there, agencies determine what services should be put up for competition and issue an RFP (request for proposals). On May 29<sup>th</sup>, the OMB issued new guidelines for competitions in OMB Circular A-76.<sup>4</sup> This circular establishes the federal policy for the competition of commercial activities. The circular provides for two different competitions:

- **Standard Competition**—used when more than 65 positions are affected, where the federal workers performing the function form a team and formally compete against private bidders on a combination of cost and performance; and,
- **Streamlined Competition**—used when less than 65 positions are affected, where management compares the costs and performance of in-house commercial activities to what is commonly available from the private sector and decides to keep the work in house or go straight to private vendors.

## 5. Where has competitive sourcing been done before?

Most of the experience with competitive sourcing is within DoD, though NASA and the Coast Guard also have done a fair amount. From 1995 through 2000, the Department of Defense completed over 550 A-76 initiatives, which resulted in an average 34 percent reduction in cost.<sup>5</sup> Overall, competitive sourcing by federal government has been growing at a rate of nearly 16 percent in recent years.<sup>6</sup>

Competitive sourcing has also been growing rapidly at the state and local level for two decades. The most recent surveys show that over 50 percent of state and local government expanded their use of competition in the 1990s and over 50 percent plan to expand their use even more in this decade.

## 6. What is the track record of competitive sourcing initiatives?

The Department of Defense (DoD) has the greatest amount of experience in competitive sourcing over all other agencies. Between 1978 and 1994 over 3,500 competitions were initiated by DoD involving 145,000 personnel. The competitions resulted in an estimated annual savings of \$1.46 billion (FY 1996 dollars).<sup>7</sup> Had the DoD competed the entire inventory of commercial function—over 13,000 functions employing over 380,000 personnel—competitions would have generated \$7.58 billion in annual savings.<sup>8</sup>

The data show an average savings of 31 percent of the baseline cost,<sup>9</sup> and that a majority of competitions remained inhouse. However, it also shows that DoD strategically used resources in the most effective and productive manner by subjecting positions to competition. DoD was able to focus more on core functions after resources were freed up due to outsourcing.



## 7. If competitive sourcing isn't just outsourcing, what are the benefits?

A recent simple story gives a good example. For years the OMB has been critical of the Government Printing Office (GPO) for high costs and lousy service. Last year the OMB decided competition was the only way to wake the GPO up, so they offered the job of printing the fiscal 2004 federal budget to competitive bidding. After much complaint and righteous grandstanding, the GPO turned in a bid that was almost 24 percent lower than its price from the previous year, enabling both sides to claim victory. The OMB said it proved competition could save the government money, while the printing office said it demonstrated that no one could beat its price. But that was \$100,000 a year that GPO could have saved taxpayers any time it chose, but it never chose to do so until it was forced to compete.

But competition isn't only about reducing costs; it very often is about achieving performance improvements so that taxpayers get better value for their money. Agencies use competition to:

- gain access to new skills and technology;
- find new ways to structure work to meet changing demand for services;
- speed up completion of needed projects; and
- uncover innovations that improve the quality of services.

A good example comes from the U.S. Post Office. After September 11th, USPS was no longer allowed to ship heavy mail on commercial airlines. So they switched to FedEx, with the unexpected result of cost savings, service improvements and significantly higher customer satisfaction. If security concerns had not forced a little competition on the U.S. Post Office those improvements would not have happened.

## 8. Does competitive sourcing really save money?

The evidence showing that well-managed competitions can save money is overwhelming.

- a. The General Accounting Office has studied DoD competitive sourcing and concluded that A-76 studies can produce cost reductions whether the competitions are won by the public or the private sector.<sup>10</sup>
- b. The Center for Naval Analysis's groundbreaking study, *Long-run Costs and Performance Effects of Competitive Sourcing*, found that competition drove down costs over 30 percent and that savings were sustained even in the long run.
- c. Reason surveyed over 100 independent studies of cost savings from competition and privatization and virtually all of the studies found that competition leads to costs savings, typically of 20 percent to 50 percent.



## 9. What is “best value”?

Best practices for government procurement and service contracting are steadily moving toward “best-value” techniques, where, rather than selecting a private partner based on low cost alone, governments choose the best combination of cost and quality. This approach has long been the standard in the Federal Acquisition Regulations, and is now the standard for competitive sourcing under OMB Circular A-76.

Best value is rooted in the simple concept of value: choosing a team to provide complex services or projects based on qualifications and technical merits, as long as the price is a value for what is promised.

Governments are beginning to recognize what every consumer already knows—sometimes if you pay more, you get more; that is, the cheapest is not always the most desirable. Requiring the government to always buy the cheapest assumes all other things are equal, which they rarely are.

The more complex the activity is, the more important issues other than lowest absolute cost will be. Best-value procurements allow all factors to be weighed appropriately when the goal is a mix of cost savings and other objectives.

## 10. What happens to affected employees?

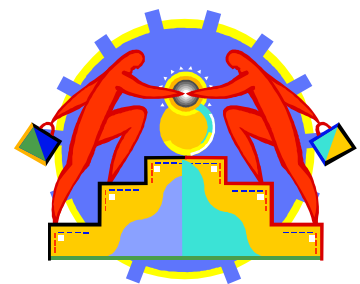
A common misconception about competitive sourcing is that it leads to layoffs and to loss of pay and benefits for workers. But every systematic study of the effects of competition on employees finds the majority hired by contractors or shifted to other jobs in government while only a small number are laid off.<sup>11</sup> A recent GAO examination of federal competitive sourcing reached similar conclusions:

*... about half of the civilian government employees remained in federal service following the studies, either in the new or another government organization with similar pay and benefits. Most of the remaining employees received a cash incentive of up to \$25,000 to retire or separate. There were a relatively small number of involuntary separations. Further, employees that left government service and applied for positions with the contractors who won the competitions were hired. Pay and benefit minimums offered by contractors are set by law for various geographical areas, which resulted in some employees making less than what they did as government employees and others making more. In many instances, former government employees who accepted employment with the contractors received a cash incentive to leave government service and federal retirement benefits. Contractor benefit packages also differed, but the types of benefits, such as health insurance, vacation time, and savings plans, appeared to be similar to what the government offers.<sup>12</sup>*

The Office of Personnel Management (OPM) mandates that agencies prepare both a Career Transition Assistance Plan (CTAP) and an Interagency Career Transition Assistance Plan (ICTAP) when a reduction in force (RIF) is expected or when an activity has been competed and outsourced to a private vendor.

## 11. Can we trust contractors?

Ultimately the government remains responsible for the service that is being performed. Thus, they have to monitor the contractor and build in strong performance measures (with penalties and incentives for poor and good work). Expertise and capabilities to manage contracts is an increasingly important priority for federal managers. However, a powerful tool has emerged to assist governments. Performance-based contracts have emerged as a state-of-the-art contracting tool to give government managers better control over contractors and greater assurances of accountability.<sup>13</sup>



Additionally, the power of the contract is often overlooked. Contracts inherently give public officials a great deal of control. They provide clauses for termination for failure to perform, while no such measure can be used with a government provision. They also introduce an additional level of accountability through the monitoring process. Government departments are largely self-policing, providing a conflict of interest, while private contractors are continuously monitored by an outside agency to assure compliance with the law and the terms of the contract.

## 12. What are some of the pitfalls, and how do we avoid them?

**a.** It is possible a winning bidder could turn out to be incapable or goes out of business. Avoid this by asking for qualifications and references from potential contractors and then spending the time checking them out. Customer references are most important (for similar-type work), but ask for credit, financial and supplier references, resumés of key personnel, and also question any legal problems.

A reasonable performance bond can help assure that the contractor will perform the contract and cover transition costs in case it does not.

However, care must be taken that requiring expensive performance bonds does not drive off smaller, but good and qualified, companies, or drive up the cost of services. References and qualifications are typically a better indicator of contract performance than performance bonds.



**b.** Sometimes a lack of understanding or agreement about performance expectations can lead to disputes and even termination. Establishing a trusting relationship requires structuring the right risks, rewards, benefits and opportunities early in the contract negotiation stage. Also, the more that the expectations of the contract are based on measurable outcomes and outputs (costs, quality, reliability), rather than inputs (like work levels, hours, personnel, etc.), the less subjective everyone's assessment will be and the less likely it is that conflicts will arise.

**c.** One pitfall may be cost overruns caused by low-ball bids or by failure to accurately assess the existing conditions and limitations of facilities. One way to avoid this is to use contracts that fix costs and risks up front. "Cost-plus" contracts provide little incentive for contractors to hold down their costs. The result is often escalating costs that the government as customer has no ability to control. Cost-plus contracts also require substantial government auditing because all the contractor's charges, invoices, and reimbursement requests must be approved by the government agency.

On the other hand, fixed price performance contracts shift the financial risk from the public agency to the contractor, who, in order to keep costs down and increase profits, has incentives to improve performance and increase productivity.

Also, competition at contract renewal—unless you have clear information that the service was performed well under the last contract—will promote good service at a competitive price. Remember that companies are interested in profits, and it is up to government to harness that drive and the competitive forces of the market to get citizens the best deal possible.

# Related Reason Public Policy Institute Publications

Carl D. DeMaio, Adrian Moore and Vincent Badolato, *Designing A Performance-Based Competitive Sourcing Process For The Federal Government*, Reason Foundation Policy Study No. 299, 2002.

Robin Johnson, *Privatization and Layoffs: The Real Story*, Reason Public Policy Institute E-brief #112, 2001

Adrian T. Moore, Geoffrey F. Segal, and John McCormally, *Infrastructure Outsourcing: Leveraging Concrete, Steel, and Asphalt with Public-Private Partnerships*, Reason Public Policy Institute Policy Study No. 272, September 2000.

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# About the Authors

**Geoffrey F. Segal** is the Director of Privatization and Government Reform Policy at Reason Public Policy Institute in Los Angeles. He has authored many studies and articles on privatization, competitive sourcing, and government budgeting and management. He is a former editor of *Privatization Watch*, and his articles have appeared in national and local publications across the nation, and he is a former columnist for *Intellectual Ammunition*, a national magazine for state legislators. Segal holds a Master's in Public Policy from Pepperdine University with specializations in Economics and Regional/Local Government. While at Pepperdine, Segal was named a Hansen Scholar. He graduated cum laude from Arizona State University with a Bachelor of Arts in Political Science.

**Adrian T. Moore** is Executive Director of Reason Public Policy Institute, the research division of the Los Angeles-based Reason Foundation, where he oversees all the Institute's policy research. His own research focuses on privatization, government reform, and infrastructure. Dr. Moore is co-author of *Curb Rights: A Foundation for Free Enterprise in Urban Transit*, published in 1997 by the Brookings Institution Press, and many policy reports on competition and privatization, as well as many articles for national and local publications. He is the publisher of *Privatization Watch* and is a former columnist for *Privatization International* and *Intellectual Ammunition*. Dr. Moore has been an advisor to many state and local government commissions on privatization and competition, including ones in Kansas, Oklahoma, Arizona, Virginia, San Diego County, Charlotte, and Washington, D.C. He holds a Ph.D. in Economics from the University of California, Irvine.

# Endnotes

- <sup>1</sup> *Long-run Costs and Performance Effects of Competitive Sourcing* (Washington, D.C.: Center for Naval Analysis, 2001).
- <sup>2</sup> The *President's Management Agenda* can be accessed at: <http://www.whitehouse.gov/omb/budget/fy2002/mgmt.pdf>
- <sup>3</sup> U.S. Office of Management and Budget, *President's Management Agenda*, p. 18.
- <sup>4</sup> U.S. Office of Management and Budget, *Performance of Commercial Activities*, OMB Circular A-76 (Revised), 2003, [http://www.whitehouse.gov/omb/circulars/a076/a76\\_rev2003.pdf](http://www.whitehouse.gov/omb/circulars/a076/a76_rev2003.pdf)
- <sup>5</sup> U.S. Office of Management and Budget, *President's Management Agenda*, p. 18.
- <sup>6</sup> Nick Wakeman, "Foreign Nations Outpace U.S. in Outsourcing," *Washington Technology*, August 28, 2000.
- <sup>7</sup> Christopher M. Snyder, Robert P. Trost, and R. Derek Trunkey, "Reducing Government Spending with Privatization Competitions: A Study of the Department of Defense Experience," George Washington University Working Paper, 2000.
- <sup>8</sup> Ibid.
- <sup>9</sup> Ibid.
- <sup>10</sup> U.S. General Accounting Office, *DoD Competitive Sourcing: Savings Are Occurring, but Actions Are Needed to Improve Accuracy of Savings Estimates* (Washington, D.C.: GAO/NSIAD-00-107, Aug. 8, 2000); and U.S. General Accounting Office, *DoD Competitive Sourcing: Some Progress but Continuing Challenges Remain in Meeting Program Goals* (Washington, D.C.: GAO/NSIAD-00-106, Aug. 8, 2000).
- <sup>11</sup> Robin Johnson, *Privatization and Layoffs: The Real Story*, Reason Public Policy Institute E-brief 112, (Los Angeles: Reason Foundation, 2001), <http://www.rppi.org/ebrief112.html>.
- <sup>12</sup> U.S. General Accounting Office, DoD, "Competitive Sourcing: Effects of A-76 Studies on Federal Employees' Employment, Pay, and Benefits Vary," GAO 01-388 (Washington, D.C.: GAO, 2001).
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*Reason*

Reason Public Policy Institute  
3415 S. Sepulveda Blvd., Suite 400  
Los Angeles, CA 90034  
310/391-2245  
310/391-4395 (fax)  
[www.rppi.org](http://www.rppi.org)